

Corporate equity securities, we have seen, are likely to continue to occupy a major position in privately organized pension programs and to become increasingly important in State and local government retirement systems. Common stocks have historically produced a higher total yield than bonds or mortgages for the holder in a position to accept price volatility and irregularity in the realization of long-term rates of return. Pension funds are particularly well situated to accept these disadvantages of corporate equity securities. The principal limitation on their role is the need to support guaranteed annuity contracts and the problems with stocks as an investment medium for employee contributions subject to withdrawal and borrowing privileges.

In the accumulation of pension fund assets for the provision of future benefits of indeterminate amount, common stocks have especially desirable characteristics. The recent changes in life insurance operations to provide for separate accounts for corporate stocks should stimulate the rate of accumulation over the immediate future. Whether the benefits of equity investment will be more widely shared with present and future pensioners by use of the variable annuity contract is less certain. The 15-year record of the College Retirement Equities Fund in providing variable benefits for educators is persuasive of the merits of this approach, but many employee groups are not anxious to trade off the certainty and stability of retirement income for the possibility of a materially higher but fluctuating average level of benefits. There are also communication problems involved, and CREF's experience may not be readily transferable to other situations. Nevertheless, a trend toward the greater use of variable annuity arrangements is the most important single factor which might affect our projected capital market flows.

Our projections show modest purchases of U.S. Government securities at some point in the future and an early cessation of net liquidation. This reflects the assumption that in the course of an orderly approach to public debt management the $4\frac{1}{4}$ percent interest rate ceiling on long-term bonds will be removed and that the Treasury will find occasions to offer securities which are attractive in comparison with alternative investments in terms of yield, freedom from an early call provision, and marketability. There is always room for marketable securities, especially as the concentration in direct placements, mortgages, and common stocks limit flexibility in portfolio management at times.

Fund management has been criticized both for being too cautious and for accepting too great risks.⁶ Equating the proportion in common stocks with high risk ignores what we know of the role of diversification—the right combination of high-risk equities, with a minimum of covariance between them, can comprise a portfolio with very limited risk. The investment of pension funds in unseasoned, marginal enterprises, on the other hand, clearly raises questions as to whether the trustees are observing the long-established standards of the prudent-man rule.

There has not been any visible pattern of relating the aversion to risk in the pension fund portfolio to the risk characteristics associated

⁶ See, for example, *Old Age Income Assurance*, pp. 19–20.